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No. 96-1157

In the Supreme Court of the United States

OCTOBER TERM, 1996

ROY H. LUCAS AND HOWARD C. LUCAS, PETITIONERS

v.

UNITED STATES OF AMERICA

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE ELEVENTH CIRCUIT

BRIEF FOR THE UNITED STATES IN OPPOSITION

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QUESTION PRESENTED

Whether an election of special use valuation of farm property under Section 2032A of the Internal Revenue Code that is invalid—because the estate failed to attach a "recapture agreement" to the estate tax return—may be perfected by an untimely submission of the required recapture agreement.

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OPINION BELOW

The opinion of the court of appeals (Pet. App.1a-29a) is reported at 97 F.3d 1401. The district court did not issue an opinion.

JURISDICTION

The judgment of the court of appeals (Pet. App. 30a-31a) was entered on October 23, 1996. The petition for a writ of certiorari was filed on January 21, 1997. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

STATEMENT

1. Charles R. Lucas died on December 15, 1985, leaving certain farm lands to his sons. His sons are

the personal representatives of his estate and the petitioners in this estate tax case (Pet. App. 2a).

The federal estate tax return for Mr. Lucas was timely filed with the Internal Revenue Service on October 16, 1986. In that return, the estate took the position that the farm land is "qualified real property" that, under Section 2032A(b) of the Internal Revenue Code, 26 U.S.C. 2032A(b), is eligible for what is known as a "special use valuation."[1] The estate did not check the box on the estate tax return that indicates that a "special use valuation" has been elected. The estate did, however, submit a notice of "special use valuation" with the return. That notice contained most, but not all, of the information required by the return. In particular, the estate did not attach to the return what is known as a "recapture agreement." A "recapture agreement," which is required whenever a "special use valuation"

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[1] Section 2032A provides a limited exception to the general rule that property is valued for estate tax purposes at its fair market value on the date of the decedent's death. If the estate elects Section 2032A treatment, and if the property will continue to be used by the family for a "qualified use" as a family farm or business for a specified number of years (26 U.S.C. 2032A(b)(2)), the estate is permitted to value qualified real estate at its value for that qualified use, rather than at its fair market value. The purpose of Section 2032A is to grant relief to the heirs of family farms—for valuing inherited farm land at its highest and best use (such as for real estate development) could produce such a large estate tax liability that the heirs would be required to sell the property in order to pay the tax. See H.R. Rep. No. 1380, 94th Cong., 2d Sess. 21-22 (1976). If the property ceases to be used by the family for a qualified use during the specified period, the estate tax saved by means of the special use election is to be "recaptured" from the decedent's heirs. 26 U.S.C. 2032A(c)(1)(B).

is sought, is an undertaking by the decedent's heirs to pay the additional estate taxes that would be due in the event the farm land ceased within 10 years of the decedent's death to be used for a qualified purpose (Pet. App. 2a-5a). See note 1, *supra*.

On audit, the Internal Revenue Service advised the estate that its "special use valuation" election was invalid under Section 2032A because the required recapture agreement was not provided with the estate tax return. Within ninety days of this notification from the Service, the estate submitted a fully executed recapture agreement. The Service determined, however, that the estate's defective election could not be perfected because its initial submission was not in substantial compliance with the requirements of the applicable regulations and did not provide substantially all the required information (Pet. App. 5a).[2]

2. The estate paid the resulting assessment and filed an administrative claim for a refund. When the claim was denied, petitioners brought this refund suit in district court and demanded a jury trial. At the close of evidence at the trial, the court awarded judg-

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[2] Under Section 2032A(d)(3), an election for special use valuation that is deficient in certain respects, but which substantially complies with the requirements of the regulations, may be perfected within 90 days after the estate receives notification from the Service of the defects in its election. 26 U.S.C. 2032A(d)(3). For the estates of decedents who died before January 1, 1986, Section 1421 of the Tax Reform Act of 1986, Pub. L. No. 99-514, 100 Stat. 2716, provides a special transitional rule that deems valid any election for special use valuation that "provided substantially all the information with respect to such election required on such return of tax" (*ibid.*).

ment to the government as a matter of law (Pet. App. 32a).

3. The court of appeals affirmed (Pet. App. 1a-31a). The court rejected petitioners' contention that the estate had "substantially complied" with the applicable regulations and was therefore entitled to correct the defects in its election pursuant to Section 2032A(d)(3). See note 2, *supra*. The court noted that, for a defective election to be cured under Section 2032A(d)(3), the original election must have substantially complied with the requirements of the regulations. In particular, the original election must have met the requirement that the estate submit a "recapture agreement" with its return (Pet. App. 11a-12a). The court held that a taxpayer cannot substantially comply with the regulations for making an election without attaching a recapture agreement because the recapture agreement is "part and parcel of a valid election" (*id.* at 13a). The court explained that "[t]he complete failure to attach a recapture agreement to the estate tax return is not the type of defect contemplated by the drafters of § 2032A(d)(3)" (*ibid.*). The court concluded that "the essential nature of the recapture agreement leads ineluctably to the conclusion that a taxpayer does not 'substantially comply' with the requirements for electing special use valuation without submitting a recapture agreement with the return" (*id.* at 15a).

The court of appeals also rejected petitioners' argument that the estate was entitled to perfect its election under Section 1421 of the Tax Reform Act of 1986, Pub. L. No. 99-514, 100 Stat. 2716. That statute permits a defective election to be perfected for an estate of a decedent who died before January 1, 1986, if the estate's initial filing furnished "substantially all

the information with respect to such election required on such return of tax" (*ibid.*). The court concluded that the phrase "information . . . required on such return" includes the "recapture agreement" that must be attached to the return (Pet. App. 27a-28a).

The court disagreed with the contrary interpretation of the statute adopted by the Seventh Circuit in *Prussner* v. *United States*, 896 F.2d 218 (1990) (*en banc*). The court explained that the Seventh Circuit's conclusion that a recapture agreement is not "information . . . required on such return" missed the critical point that the recapture agreement is "information" required on the return, even if the agreement itself is attached to (and not "on") the return (Pet. App. 25a). The court of appeals noted that the requirement of a recapture agreement appears on the face of the estate tax return filed by the estate in this case and concluded that the "recapture agreement constitutes 'information with respect to such election required on such return of tax' for purposes of § 1421(a)(2)" (*id.* at 28a).

ARGUMENT

The court of appeals correctly held that the estate did not validly cure its defective election of a special use valuation. The holding of the court of appeals that the estate is not eligible for relief under Section 2032A(d)(3) does not conflict with any decision of this Court or any other court of appeals. And, while the court's further holding that the estate was not eligible for relief under Section 1421 of the Tax Reform Act of 1986 conflicts with the decision of the Seventh Circuit in *Prussner* v. *United States*, 896 F.2d 218 (1990), that conflict lacks recurring importance for it

involves the scope of a transitional rule that has application only to the estates of decedents who died before January 1, 1986. Further review is therefore not warranted.

1. a. Section 2032A of the Internal Revenue Code provides a substantial tax benefit to the heirs of certain types of real property. It permits an estate to elect to value qualifying real estate (such as farm or ranch land) for estate tax purposes based upon the actual and intended use of the property as a family business, rather than upon its highest and best use. See note 1, *supra*. Several conditions must be satisfied for the property to qualify for this favorable tax treatment.

Section 2032A and 26 C.F.R. 20.2032A-8(a)(3) establish the procedures that must be followed to make a valid election for special use valuation. They require the executor to file, as part of a timely estate tax return, (i) a notice of election that identifies all persons who have interests in the specially valued property and (ii) an agreement under which each of the heirs consents to liablility for the recapture of the special estate tax benefits in the event that a premature disposition of the property or a cessation of its qualified use occurs within a specified period. See 26 U.S.C. 2032A(c)(1)(B); 26 C.F.R. 20.2032A-8(c)(1); *Estate of Hudgins* v. *Commissioner*, 57 F.3d 1393, 1398-1399 (5th Cir. 1995); note 1, *supra*.

Under Section 2032A(d)(3), a defective election may be perfected later only if the initial election, though defective in minor respects, was in "substantial compliance" with the requirements of the applicable regulations. 26 U.S.C. 2032A(d)(3). The legislative history of this provison states that "[b]oth a notice of election and an agreement that themselves evidence

substantial compliance with the requirements of the regulations must be included with the estate tax return, as filed, if the estate is to be permitted to perfect its election." H.R. Conf. Rep. No. 861, 98th Cong., 2d Sess. 1241 (1984). To be valid under the regulations, a recapture agreement must be in a form that is binding under local law and must be executed by all parties with interests in the property as of the decedent's death. The heirs must expressly consent to personal liability for the recapture of the special benefits in the event that a premature disposition of the property or a cessation of its qualified use occurs. See 26 C.F.R. 20.2032A-8(c). As the Conference Report further specifies (H.R. Conf. Rep. No. 861, *supra*, at 1241):

> To be eligible for perfection, the agreement as originally filed must at a minimum be valid under State law and must include the signatures of all parties having a present interest or a remainder interest other than an interest having a relatively small value.

b. The court of appeals correctly held that the estate was not eligible to perfect its defective special use valuation election under Section 2032A(d)(3). The estate failed to file any type of recapture agreement with the estate tax return. The heirs thus did not consent to the imposition of the recapture tax. Because the existence of a valid and enforceable recapture agreement is fundamental to the special use valuation election, it cannot be said that the imperfect election submitted by the estate "substantially complied" with the requirements of the regulations, as the statute mandates (26 U.S.C. 2032A(d)(3)(B)). As the court of appeals correctly concluded, the failure to

attach this required agreement is not a technical or minor defect that may later be cured under Section 2032A(d)(3) because the recapture agreement is an indispensable ingredient of any special use valuation election (Pet. App. 13a).

Every court that has ruled on this question has reached this same conclusion. "During the decade since subsection (d)(3) was added to § 2032A by [the 1984 legislation], in not one case in which no Recapture Agreement (or other contractually sufficient substitute, personally binding the qualified heirs and enforceable under state law) had been submitted contemporaneously with the estate tax return has substantial compliance been found and post-filing perfection permitted." *Estate of Hudgins* v. *Commissioner*, 57 F.3d 1393, 1405 (5th Cir. 1995). See *McDonald* v. *Commissioner*, 853 F.2d 1494 (8th Cir. 1988), cert. denied, 490 U.S. 1005 (1989); *Foss* v. *United States*, 865 F.2d 178 (8th Cir. 1989); *Prussner* v. *United States*, 896 F.2d at 222; *Bartlett* v. *Commissioner*, 937 F.2d 316 (7th Cir. 1991).[3]

3. The court of appeals also correctly rejected petitioners' contention that the estate's defective election could be perfected under Section 1421 of the

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[3] Petitioners err in contending (Pet. 26-28) that the absence of a recapture agreement was not material because, as personal representatives of the estate, they would be personally liable under state law for any additional federal estate tax later imposed. Liability for federal estate taxes is a matter of federal law, not state law. Under Section 2204 of the Code, the executor or personal representative of an estate, upon payment of the amount of the estate tax determined by the Internal Revenue Service, is generally "discharged from personal liability for any deficiency in tax thereafter found to be due . . ." 26 U.S.C. 2204.

Tax Reform Act of 1986. That statute applies only to the estates of decedents who died before January 1, 1986. By its terms, it limits relief to situations in which the executor provided "substantially all the information with respect to such election required on such return of tax." See pages 4-5, *supra*. The legislative history discloses that this provision was enacted because incomplete instructions on one edition of the 1982 estate tax return (Form 706) had caused some taxpayers to fail to comply with the regulatory requirements for making a valid election. See S. Rep. No. 313, 99th Cong., 2d Sess. 876 (1986); H.R. Conf. Rep. No. 841, 99th Cong., 2d Sess. Pt.2, at 770-771 (1986).

The March 1985 version of the Form 706 used by the estate in this case, however, expressly specified that a valid and enforceable recapture agreement, signed by all of the heirs, must be submitted with the return (Pet. App. 28a). Indeed, petitioners do not contend that the estate's failure to comply with this regulatory requirement had anything to do with any error in the instructions on the return. In this context, the court of appeals correctly held (*id.* at 29a) that, by failing to submit the recapture agreement with the return, the estate did not "provide[] substantially all the information with respect to such election required on such return of tax" (100 Stat. 2716) and is therefore not eligible for the relief provided by Section 1421 of the Tax Reform Act of 1986.

Petitioners correctly point out (Pet. 16) that the Seventh Circuit reached a different conclusion in *Prussner* v. *United States*, *supra*. In *Prussner*, the court held that the phrase "information with respect to such election required on such return of tax" in Section 1421(a)(2) does not include the recapture

agreement that is "required on such return" because that agreement is to be attached to, not placed "on," the return. 896 F.2d at 225-226. In our view, however, the decision in *Prussner* is incorrect for the reasons carefully and clearly explained in comprehensive detail by the court of appeals in this case (Pet. App. 16a-29a).

Further review of this conflict is, in any event, not warranted. Section 1421 is a transitional rule that, by its express terms, applies only to the estates of decedents who died before January 1, 1986. The conflict between the Seventh and Eleventh Circuits as to the proper scope of the relief provided under Section 1421 for invalid special use elections thus plainly lacks any recurring importance.

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted.

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